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THE 1976 CURRENT SERVICES BUDGET

A STAFF STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY
IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES



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LETTERS OF TRANSMITTAL

DECEMBER 30, 1974.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the Members of the Joint Economic Committee and other Members of Congress, is a study entitled "The 1976 Current Services Budget." The study has been prepared by the members of the staff of the Joint Economic Committee and the Congressional Research Service at the Library of Congress with the assistance of the staff of the Joint Committee on Internal Revenue Taxation.

The study is analytic in nature and makes no policy recommendations. Nothing in the study should be interpreted as representing the views or recommendations of the Joint Economic Committee or any of its individual Members.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

DECEMBER 26, 1974.

HON. WRIGHT PATMAN,
*Chairman, Joint Economic Committee, Congress of the United States,
Washington, D.C.*

DEAR MR. CHAIRMAN: Transmitted herewith is a study entitled "The 1976 Current Services Budget." This study was undertaken at the request of the Senate and House Budget Committees. Beginning in fiscal year 1977 this document will be prepared by the Office of Management and Budget and submitted to the Senate and the House of Representatives on or before November 10. The intent is to provide Congress, at the earliest date, with reasonably detailed information with which to begin analysis and preparation for the formulation of the budget for the fiscal year beginning on the following October. The Joint Economic Committee will review the estimated outlays and the proposed budget authority submitted in this document and provide evaluation of these figures for the Budget Committees prior to December 31 of each year. Because the new Budget Committees wished to make a trial run of these procedures on the 1976 budget, I am pleased to be able to present a current services budget for their use.

It should be emphasized that the staff has prepared a "baseline" projection of 1976 expenditures. Essentially, this is an estimate of what expenditures would be if existing programs were allowed to grow at rates predetermined by legislation already enacted and by current and anticipated economic conditions. It is in no sense a recommendation of what the expenditure total should be or of the allocations that should be made within the total. Nothing in this study should be interpreted

as representing the views or recommendations of the Joint Economic Committee or any of its Members.

I am pleased to be able to make this study available to the Members of the Budget Committees and other Members of Congress, and I believe it will be very helpful in providing the information necessary to begin work at an early date on the 1976 budget. Preparation of this study involved the cooperation of many different people. Douglas Lee and Courtenay Slater of the Joint Economic Committee staff, Nancy Teeters, Tina Perchik, and Ruth Rowan of the Congressional Research Service, Library of Congress, and several other staff personnel participated in the preparation of the study. Revenue estimates were prepared at the committee's request by the staff of the Joint Committee on Internal Revenue Taxation, based on an economic forecast supplied by the staff of the Joint Economic Committee. The staff of the Office of Management and Budget was most cooperative in providing technical assistance, but nothing in the study should be construed as representing the views of the Executive branch of the Government.

I would like to express my own appreciation to the committee staff and to the Congressional Research Service personnel who prepared this study. We also appreciate the cooperation and assistance of the staff of the Joint Committee on Internal Revenue Taxation and the staff of the Office of Management and Budget.

WILLIAM PROXMIRE,
*Chairman, Subcommittee on Priorities
and Economy in Government.*

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Part I. INTRODUCTION AND REVIEW

The Joint Economic Committee has for a number of years urged Congress to focus attention earlier on the coming year's budget. The committee has felt that if Congress is to control spending effectively and set budget priorities this is an absolute necessity. In order to assist Congress in focusing on future budgets, the Joint Economic Committee published a staff study, "The 1975 Budget: An Advance Look," on December 27, 1973. This study provided a baseline projection of receipts and expenditures as we expected them to exist in fiscal year 1975. A baseline budget is not a prediction or a proposal of amounts of money which should be spent. Rather it demonstrates how spending levels in the current year influence spending levels in the following year. Only by understanding the degree to which Congress is locked into future spending by today's actions can Congress control future spending.

The current services budget has now been officially incorporated into the congressional budget review process. The Congressional Budget Act of 1974 requires the President to submit a current services budget to Congress on or before November 10 of each year. The Joint Economic Committee is charged with reviewing this budget and providing an evaluation to the Budget Committees of the House and Senate by the end of the year. Although these procedures do not become effective until the fall of calendar year 1976, the new Budget Committees felt that it would be beneficial to make a trial run of as many of the new procedures as possible in reviewing the 1975 budget. The Budget Committees have asked the Joint Economic Committee to supply as much information on the 1976 budget as possible, and we are pleased to be able to do this.

It is important to understand that these baseline projections are based on our estimates of what will be spent during the current fiscal year and our projections of the economic conditions which will prevail for the next year and a half. There is obviously a large margin of error built into this approach. Fiscal year 1975 is only one-half over, and Congress may need to consider supplemental spending measures in the next session. In addition, the Executive branch could still make recommendations which could alter present spending rates. A sharp departure of economic conditions from present expectations or a change in the tax policy could produce an unanticipated speed-up or slow-down of government outlays and receipts. Our estimates are based on the most complete information available at the time this document was sent to press, however, they may need to be revised in light of future developments.

The baseline projections do not take into account future policy changes, new program initiatives, or legislation which has not been acted upon. The baseline represents existing government program and activities. We have made one exception for legislation enacted by

Congress but not yet signed by the President. In making the projections we are simply showing what the programs now on the books will cost next year.

This study presents projections only for the current fiscal year and for the fiscal year immediately following. We are fully aware of the desirability of looking further ahead. Beginning next year, we expect to be able to make projections 5 years into the future. Hopefully, next year we will also be able to provide information on a functional and subfunctional level as required by the Congressional Budget Act of 1974.

Our projections for fiscal year 1976 included a discussion of the underlying economic assumptions. We believe that our estimates are reasonable and by making the assumptions explicit, all readers will have the opportunity to fully evaluate our conclusions. We hope this study will provide Congress with some assistance in their efforts to look ahead.

Part II. THE CURRENT SHAPE OF THE 1975 BUDGET

During the first 6 months of fiscal 1975 the key word has been "restraint." Curbing spending toward the expected revenue levels has been advocated by both the Congress and the Administration. At the same time, inflationary and recessionary pressures have required expansion beyond the original budget estimates for unemployment assistance, interest on the national debt and several other areas. As shown in table 1, the total budget outlays are presently estimated to be \$3.4 billion higher than the original February estimate.

Generally, inflation enlarges Federal revenues because of the progressive nature of the income tax structure. Revenues for fiscal 1975, though, are expected to be lower than the original estimate because the recessionary impact of high unemployment levels has outweighed inflationary increases. In addition, widespread changes in corporate inventory accounting methods to reduce inflation-generated inventory profits have lowered revenue estimates. Thus, as revenue projections were revised downward, the possibility of actually balancing the budget became more remote.

On the expenditure side of the budget there have been many changes both up and down. The largest single area of reductions was in the Department of Defense. Congress reduced outlays by \$3.1 billion, but this reduction was partially offset by increases of \$0.9 billion for unanticipated wage and fuel expenditures resulting in a net reduction of \$2.2 billion. It should be noted, however, that thus far this year the Department of Defense has been spending at a rate which would if continued lead to total outlays almost \$4 billion higher than the most recent official estimate of \$83.6 billion.

Oil lease sales on the Outer Continental Shelf are treated as offsets to outlays and thus far this year have been revised by \$3 billion. This amount is especially difficult to estimate because it is affected by so many different factors. Lack of adequate geological information, fluctuations in the world price of oil, environmental considerations and many other problems may affect both the receipts and the timing of these sales. Lower sales than now projected would result in an increase in total outlays.

Estimated budget outlays for the Environmental Protection Agency have been reduced by \$1 billion. This is subtracted from their original budget estimate because of time lags in their anticipated schedule for sewage treatment construction.

Other reductions below the original February estimate have occurred in Medicare and the Social Security Trust Fund (OASDI). Asset sales by the Farmers Home Administration which are considered negative outlays have increased.

Recessionary pressures have caused an estimated \$5.3 billion increase in unemployment-related expenditures. Because the original February estimate was based on a projected rate of unemployment much lower than what has in fact occurred, additional outlays of \$3.6 billion are

necessary to pay for the increased number of recipients, and the extended benefits program added another \$700 million. This extended benefit program increases the duration of benefits from 26 weeks to 39 weeks when the national unemployment rate for those covered by unemployment insurance exceeds 4.5 percent for 3 consecutive months. Legislation passed by Congress but not yet signed into law would extend benefits further from 39 weeks to 52 weeks at a cost of about \$.5 billion. In addition, Congress has approved the National Employment Assistance Act. This extends coverage to workers not previously covered and provides a public service employment program. Since the cost of public service employment depends on the rate at which States and localities spend the funds it is extremely difficult to estimate. We estimate total outlays from NEAA to be about \$2 billion, including the extended benefit coverage.

TABLE 1.—1975 outlays—major changes from the February budget estimates

[In billions of dollars]	
February budget estimate of 1975 outlays.....	304. 4
Unemployment changes:	
Unemployment trust fund, including effects on extended benefits.....	3. 6
National employment assistance ¹	2. 0
Federal extended benefits, legislative proposals (replaced by national employment assistance).....	-. 8
Extension of benefits from 39 to 52 weeks.....	. 5
Total changes.....	5. 3
Defense changes:	
Congressional changes to defense appropriations (including 1974 supplemental).....	-3. 1
Federal pay raises.....	. 5
Other changes, including fuel cost increases.....	. 4
Total changes.....	-2. 2
Other changes:	
Veterans benefits.....	1. 5
Veterans service-connected compensation.....	. 6
Interest on the public debt.....	2. 5
EPA construction grants.....	-1. 0
Medicare; old-age, survivors, and disability trust funds.....	-1. 0
Education program reestimates.....	-. 4
Offshore oil receipts.....	-3. 0
Farmers Home Administration asset sales.....	-. 8
Housing programs.....	. 5
All other.....	1. 4
Total changes.....	. 3
Revised budget estimate of 1975 outlays.....	307. 8
Executive November 26 proposals to reduce 1975 spending.....	-4. 6
1975 outlays including rescissions and deferrals.....	303. 2

¹ This legislation has been enacted but not yet signed into law.

Interest on the public debt is another category that added \$2.5 billion to the original estimates. This is due to the higher than expected interest rate on Federal securities resulting from the economic conditions. Increased benefits for veterans account for \$2.1 billion of the increase in outlays. The majority of this is based on two congressional actions both within the veterans benefits on table 1. Congress

has increased veterans educational benefits at a cost of \$.6 billion. In addition, the delimiting period of eligibility for veterans educational benefits has been extended from 8 to 10 years following active service. This is estimated to add \$.6 billion to 1975 outlays.

Housing programs are increased by \$.5 billion. This amount is comprised partly of the release of frozen funds of \$389 million in model cities, urban renewal and the neighborhood development projects. These are used as transitional funds for community development block grants under the Housing and Community Development Act of 1974. The remainder of the increase reflects the reestimate of outlays under the GNMA tandem plan.

When all of the above changes are consolidated, the budget is estimated at \$307.8 billion—\$3.4 billion over the original February estimate. The \$4.6 billion deduction at the bottom of table 1 represents the 1975 outlay impact of the President's November 26 proposals for rescissions and deferrals.

Part III. AN EXPENDITURE BASELINE FOR 1976

The figures presented for 1976 in this study are baseline projections or projections of the "current services" budget. They are not an attempt to predict the future or to anticipate the official 1976 budget. Rather, they represent an effort to show how existing programs will change based on current law and projected changes in prices, wages and workload. That is, they show the amount it will cost in 1976 to provide the same level of services which the Government provided in 1975 plus any changes mandated by laws which become effective in 1976.

Typically we observe expenditures on Federal programs growing over time. A large part of this is automatic growth which occurs even in the absence of policy changes. As population characteristics change more people may become eligible for Federal benefits. This accounts for much of the increase in social security costs, military and civil service retirement costs, and some public assistance programs. There are also wage increases which must be paid to keep Federal pay levels comparable to those in private industry. A third reason Federal programs tend to grow over time is inflation. Some programs such as civil service and military retirement, food stamps and social security benefits have provisions in the legislation which guarantee that expenditures will increase as prices increase. Programs such as medicare reflect the effects of inflation because they reimburse people for private expenditures. Other programs do not increase automatically, but if the level of goods and services provided is to remain constant, dollar spending must be raised.

In fiscal 1976 the level of real economic activity will have a very significant impact on the Federal budget. During recessionary periods when unemployment rates increase the cost of providing unemployment benefits naturally rises. There are also some other increases in programs such as food stamps, social security benefits and other welfare-type programs which rise more rapidly during periods of slow or negative economic growth. For example, outlays from the Department of Labor are projected to increase from \$16.3 billion to \$19.4 billion between 1975 and 1976. Most of this increase is due to unemployment benefits. The number of people on our unemployment roles is expected to expand and the average benefits are expected to increase. In addition, the present law providing for extended benefits is assumed to be continued. Estimates for the outlay impact of new legislation providing for public service jobs and additional benefits has been included in the projection based on the assumption that this legislation will become law.

The major areas of increase shown in the 1976 current services projection will be beneficiary programs and defense. Transfer payments for old-age, survivors, and disability insurance (OASDI), unemployment compensation, and veterans benefits constitute most of the increase in total outlays from 1975 levels. Payments to beneficiaries

grow under existing legislation for three reasons: First, the number of beneficiaries is sensitive to economic and demographic conditions; second, the dollar value of benefits increases with price increases; third, the level of real benefits (after adjustment for inflation) continues to grow even in the absence of new legislation reflecting past increases in wages used to compute benefits.

The number of beneficiaries for OASI grows as the proportion of the retired population covered by social security and other retirement programs increase. The number of eligibles for unemployment compensation depends on the number unemployed which obviously is quite sensitive to economic conditions. Beneficiaries of welfare payments also grow as economic conditions worsen and people exhaust their unemployment benefits and are forced onto welfare roles.

Payments for OASI are projected to increase \$7.3 billion, or 13 percent over the current 1975 estimate. Insurance claims, the largest object category of OASI outlays, were projected on the basis of price, population, and real growth factors. Price growth of 6.7 percent for 1976 was based on the 1975 growth of CPI, as defined by law. Population growth, 3 percent, is based on the historical relationship of the change in beneficiaries to increases in population of retirement age. Real increases (increases after legislative and price increases have been subtracted) are based on a historical growth of 3.7 percent.

The 1976 outlays for Supplemental Security Income, replacing programs of public assistance to the aged, blind, and disabled as established by the Social Security Amendments of 1972, are projected to rise by 3.7 percent over the original 1975 outlays estimates. This growth in outlays is based entirely on an increase in beneficiaries, reflecting the historical relationship between benefits and the growth in unemployment.

Unemployment compensation is projected to rise in 1976 by \$5.2 billion over the current 1975 estimates. This represents an increase of \$8.1 billion over the original 1975 estimate. Part of the increase is due to the tremendous increase in the number of unemployed. Those covered by UI laws are entitled to 26 weeks of compensation. Since the covered unemployment rate is expected to be over 4.5 percent nationally throughout fiscal year 1976, an additional 13 weeks of benefits are automatically triggered on for States. When the covered unemployment rate is 4.5 percent, the overall unemployment rate is around 6 percent, since many of the unemployed either have no previous work experience to qualify them for benefits, or they work in industries which are not covered by unemployment insurance. Because the projected level of unemployment is well above 6 percent (see table 3) it was assumed these extended benefits would be triggered beginning in mid-1975.

Increases in basic benefits due to the rise in unemployment comprised \$3.7 billion of the increase in 1976 over the 1974 levels, while the extended benefits accounted for an additional \$1.4 billion. Increasing average benefits accounted for the additional change in outlays.

Legislation recently enacted by Congress would extend unemployment benefits to a total of 52 weeks, extend coverage to include those not previously covered for the basic 26 weeks, and provide for public service jobs. We have estimated that this package will add about \$1 billion to outlays in fiscal 1975. In fiscal year 1976, the total cost will

be approximately \$3.5 billion. These estimates have been incorporated in tables 1 and 2 on the assumption that they will become law.

TABLE 2.—1975 OUTLAYS AND PROJECTED 1976 OUTLAYS BY AGENCY

[In billions of dollars]

	1975		1976 projected
	February estimate	Current estimate	
Legislative.....	0.7	0.7	0.8
Judiciary.....	.3	.3	.3
Executive Office of the President.....	.1	.1	.1
Agriculture.....	9.2	8.8	10.1
Commerce.....	1.7	1.7	1.7
Defense:			
Military.....	84.6	83.6	94.0
Civilian.....	1.6	1.8	1.8
Health, Education, and Welfare.....	111.0	110.2	122.9
Housing and Urban Development.....	5.6	5.7	6.3
Interior ¹	2.0	2.4	2.0
Justice.....	2.1	2.0	2.2
Labor.....	10.0	16.3	19.4
State.....	.8	.8	.9
Transportation.....	9.1	9.1	9.8
Treasury.....	37.6	40.1	40.8
Atomic Energy Commission.....	2.9	3.1	3.2
Environmental Protection Agency.....	4.0	2.9	3.9
General Services Administration.....	-.9	-.8	0
National Aeronautics and Space Administration.....	3.3	3.3	3.4
Veterans.....	13.6	15.6	16.2
Other Agencies.....	18.9	18.7	19.7
Undistributed offsetting receipts:			
Royalties, Outer Continental Shelf.....		-7.7	-7.7
Interest received by trust funds.....			-8.1
Other.....			-3.8
Allowances and contingencies.....	1.6	(3)	3.5
Total.....	304.4	307.8	346.4

¹ Rent on Outer Continental Shelf (offshore oil leasing) is an undistributed offsetting receipt. Current 1975 estimates are \$7,700,000,000, and this figure was used as the 1976 projection. These receipts are erratic and any projection is subject to a large margin of error.

² Not available.

With the exception of the transfer programs, most government expenditures were assumed to remain constant in real terms. That is, the only adjustment made was for increases in price of goods and services.

Part IV. RECEIPTS AND THE ECONOMIC IMPACT OF THE BUDGET

The Federal Budget is the document which describes the fiscal policy being pursued by the National Government. The question most frequently asked about this fiscal policy is: Will this policy restrain or stimulate the economy?

The standard often chosen for evaluating the need for stimulus or restraint is the estimated real output which our economy is potentially capable of producing. This potential amount of output assumes a constant growth in productivity, a constant level of resource utilization, and a decline in the average hours worked based on past experience. Once the potential output level is determined, the level of Federal tax receipts and expenditures which would occur if we were actually producing this potential output can be estimated. Having made these calculations one is then in a position to decide whether the actual budget being forecast is moving the economy in the direction of the standard of comparison or away from it and whether this movement is desirable or should be corrected.

In fiscal year 1975, unified budget receipts are estimated to be approximately \$285 billion. This estimate is below the current official estimate of \$293 billion. The worsening economic situation, combined with the switch by many corporations from the first-in, first-out (FIFO) to last-in, first-out (LIFO) inventory accounting methods and the unlikelihood that the Administration's surtax proposal will be adopted have combined to lower the probable level of receipts. As shown in table 2, expenditures in fiscal 1975 are projected to be \$307.8 billion. This implies a deficit in the fiscal 1975 budget of almost \$23 billion.

Based on the information presented in this study, we have made calculations for the amount of receipts and expenditures which would be realized by the Federal Government if we were operating at our potential level of output.¹ Our calculations show that the surplus which would occur in the first half of 1975 would be approximately \$17 billion (annual rate). In the second half of fiscal 1975 the surplus is projected to grow \$10-\$12 billion, approaching \$30 billion. Increasing the surplus will tend to push the economy further away from its potential growth path and must therefore be regarded as a restrictive budget posture despite the \$23 billion actual deficit implied in our projections for 1975.

¹ The level of resource utilization assumed in this calculation is consistent with having 96 percent of the civilian labor force employed.

TABLE 3.—ECONOMIC ASSUMPTIONS

[Dollar amounts in billions]

	Calendar year—	
	1974	1975
Gross national product.....	\$1,402	\$1,504
Personal income.....	\$1,151	\$1,243
Corporate profits before tax.....	\$142	\$135
3-month Treasury bill rate (percent).....	7.87	6.22
Unemployment rate (percent).....	5.6	7.2
Percent change:		
Consumer Price Index.....	11.0	9.4
Deflator—GNP.....	10.5	9.1
Deflator—Private purchases.....	9.9	9.3

Looking ahead to fiscal year 1976, revenues are expected to be approximately \$310 billion. This estimate was prepared by the staff of the Joint Committee on Internal Revenue Taxation based on a forecast made by the staff of the Joint Economic Committee. The essential elements of this forecast are shown in table 3. Combining \$310 billion in receipts with \$346 billion in outlays means that in order for the Federal Government to provide the same level of services in 1976 which were provided in 1975, it will have to run a deficit exceeding \$36 billion. Our calculations of the surplus or deficit which would occur if we were operating at potential levels in fiscal year 1976 show very little change from the \$30 billion level of the surplus we project in the second half of fiscal 1975. This leads to the conclusion that the \$36 billion deficit projected in the actual budget for fiscal year 1976 represents a rather neutral fiscal policy. This \$36 billion deficit will not stimulate the economy back toward our potential standard nor will it move us any further below that standard than we have already fallen. In the event that revenues are reduced through tax reductions there will be some stimulus to the economy although the amount of stimulus will obviously depend upon the amount of tax reduction.